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US poll result: India to be one of the gainers despite demanding valuations

Emerging Markets including India could offer a more compelling opportunity than developed markets.

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With the long-delayed verdict of the US election behind us, the market can breathe a sigh of relief now. As of date, it appears Joe Biden will have to contend with a fractured mandate with the Senate being controlled by the Republicans though this could possibly change by January.

The big worry for the market from a Joe Biden victory has been that we will see an increase in corporate taxes. In that sense, the market is a bit relieved with a split verdict since tax increases may not be easy to pass in the Senate. Overall, we have three points on the impact of elections on markets. First, we believe that the impact of most elections on markets is over-stated and they have only a very short term impact on the markets.

The Fed policy and the availability of a virus will continue to be important drivers of the market. Secondly, history shows that the first year post-election is generally good for markets irrespective of a Democrat or Republican President with the lone negative spell being driven more by the tech bubble crash in 2000 than the elections.

Thirdly, if we look at history, a Republic or Democrat Government has not really mattered with markets giving a positive return in regimes of both parties. If anything, Democrat President tenures have provided higher average returns of 47 per cent than Republic President tenures of 15 per cent.

Within equities, we believe Emerging Markets including India could offer a more compelling opportunity than developed markets. Firstly, developed markets have outperformed emerging markets by a wide margin. Since the Global Financial Crisis (GFC) in 2008, emerging markets are up 110 per cent way below developed markets which are up nearly 170 per cent.

The EM index valuations are attractive at a PE of 14.5x, a 25 per cent discount to the world markets. This backdrop provides an ideal platform for mean reversion trade in favour of emerging markets. Secondly, US corporate earnings could be close to peaking while emerging markets are seeing corporate profitability well below historical averages. And here, we are not even considering the impact of any possible increase in corporate taxes. In case the Biden tax proposals get implemented, we will see a 7 per cent reduction in corporate earnings.

In contrast, in India, for example, we are seeing anaemic earnings growth of 5-6 per cent over the past decade well below historic averages. Cost-cutting and a revival in the economy could see earnings double over the next five years. One question we get is we are likely to see a strong stimulus in the USA and with a continued Fed monetary expansion, could we see growth continue to surprise and surpass emerging markets.

Typically, periods of rising global economic growth have seen emerging market economies as well as stock markets do better. The third point which is linked to this is that emerging market currencies are cheaper than developed markets. A large stimulus and easy Fed policies could lead to a depreciation of the US dollar which is always positive for emerging market equities. Over the past decade, the dollar index has appreciated by close to 10 per cent which has hurt emerging market equities.

One small last point is the performance of the technology stocks (FAANGs) that have driven a large part of the US market returns. While these companies will continue to grow current valuations are no longer cheap. Any regulatory changes, both by the US Government as well as Governments in other countries, could be negative for these stocks.

Within emerging markets, we think India will be one of the gainers in spite of its more demanding valuations. Firstly, in terms of flows, India is well-positioned with a likely MSCI re-balancing in November likely to add to India's weight in the index. We think India's weight in MSCI EM could go up from 8.1 per cent to around 8.7-8.8 per cent enabling over US$2 billion of flows. Secondly, as we mentioned earlier, we are at a cyclically low point in the earnings cycle and we should mean revert over the next few years. One specific advantage to India from the Democrat Government could be easier immigration and H1-B visa regulations that help our tech companies.

Finally, just like everywhere else, the hope is of a vaccine that helps normalisation of the economy over the next six months. With the slowdown in the world, the Indian economy was the worst impacted. Consequently, as things revert to normal, we could see India being one of the fastest-growing economies in the world again.

Jyotivardhan Jaipuria is the founder of Valentis Advisors. Views are his own.